St. Petersburg University
Graduate School of Management

Master in Corporate Finance

LEVEL OF COMPLIANCE WITH BEST CORPORATE GOVERNANCE PRACTICES AND COMPANY VALUE: EVIDENCE FROM RUSSIAN PUBLIC COMPANIES

Master's Thesis by the 2nd year student

Concentration — Corporate Finance

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ЗАЯВЛЕНИЕ О САМОСТОЯТЕЛЬНОМ ХАРАКТЕРЕ ВЫПОЛНЕНИЯ ВЫПУСКНОЙ КВАЛИФИКАЦИОННОЙ РАБОТЫ

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АННОТАЦИЯ

Автор	Надькина Екатерина
Название магистерской диссертации	Уровень соответствия лучшим практикам корпоративного управления и стоимость российских публичных компаний
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Описание цели, задач и основных результатов	Цель данного исследования – выявление взаимосвязи между уровнем соответствия лучшим практикам корпоративного управления и рыночной стоимостью российских публичных компаний. Для достижения поставленной цели были сформулированы следующие задачи: – проанализировать лучшие практики корпоративного управления в России; – изучить существующие исследования взаимосвязи различных механизмов корпоративного управления и стоимости компании; – провести эмпирическое исследование для тестирования сформулированной гипотезы; – сформулировать выводы и практические рекомендации. В результате исследования была установлена положительная взаимосвязь между уровнем соответствия лучшим практикам корпоративного управления и рыночной стоимостью компании, выраженной коэффициентом Тобина
Ключевые слова	Лучшие практики корпоративного управления, стоимость компании, Кодекс корпоративного управления

ABSTRACT

Master Student's Name	Yekaterina Nadkina
Master Thesis Title	Level of compliance with best corporate governance practices and company value: evidence from Russian public companies
Faculty	Graduate School of Management
Main field of study	Corporate Finance
Year	2017
Academic Advisor's Name	Associate Professor Yulia B. Ilina
Description of the goal, tasks and main results	The goal of the research is to investigate the relationship between the level of compliance with best corporate governance practices and firm market value for Russian public companies. In order to reach this goal the following research objectives were stated: − to analyze best corporate governance practices in Russia; − to study existing research papers on the relationship between different mechanisms of corporate governance and company value; − to conduct the empirical study to test the formulated hypothesis; − to come up with conclusions and managerial implications. The result of this study is the following: there is a positive relationship between the level of compliance with best corporate governance practices and company market value measured as Tobin's Q
Keywords	Best corporate governance practices, company value, the Code of Corporate Governance

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Introduction

The study is devoted to the investigation of the relationship between the level of compliance with best corporate governance practices and firm market value for Russian public companies.

Today the issue of corporate governance in Russia is becoming more and more crucial. In comparison with other emerging markets, shares of Russian public companies are proved to be undervalued, which is one of the consequences of poor corporate governance. In order to be efficient in terms of corporate governance, companies need some guidelines or standards based on best international and Russian practices. The main purpose of introducing those standards is to protect the rights of shareholders, thus making investing in Russian companies more attractive. As for today, the main source of best corporate governance practices in Russia is the Corporate Governance Code issued in 2014, which not only provides the best standards of shareholders rights observance and contributes to their implementation in practice, but is also a good manual for effective company management and long-term sustainable company development. The adoption of the Code is caused by the accumulated knowledge in corporate governance, changes in legislation and lessons learned from the recent financial crisis. The document contains recommendations, which are mainly addressed to public companies and big state-owned enterprises.

The importance of the research is supported by the new requirements in terms of corporate governance from the side of the government. Firstly, some provisions of the Code are obligatory for companies to be included in the first and second quotation levels. Secondly, the government made compliance with the Code mandatory for 13 state-owned companies in 2014. Finally, starting from December, 2014 every public company has to include the information on compliance with the Code in its annual report.

As the Corporate Governance Code is supposed to significantly improve corporate governance in Russian public companies, it is necessary to define whether compliance with the Code recommendations contributes to increase of company value. Moreover, since the Code provides recommendations, but not requirements, companies do not necessary have to follow all the provisions and might have doubts whether the compliance with the Code is beneficial for them.

Therefore, the goal of the research is to investigate the relationship between the level of compliance with best corporate governance practices and firm market value for Russian public companies. The relevance of the paper is supported by the absence of prior research on the topic due to the Code recent issuance. Based on the research goal, it is possible to formulate the research question: “Is there any relationship between the level of compliance with best corporate governance practices and firm market value for Russian public companies?”

In order to achieve the goal of the research and define the relationship between the level of compliance with best corporate governance practices and company value the following research objectives were identified:

1. To analyze best practices of corporate governance in Russia
2. To provide a review of both Russian and foreign literature dedicated to corporate governance and its relationship with company value
3. To conduct the empirical analysis aimed at the identification of the relationship between the level of compliance with best corporate governance practices and company value
4. To analyze the results of empirical analysis, come up with conclusions and give recommendations to companies

The paper is organized in a way, so that research objectives are successively accomplished. The first chapter provides broad analysis of theory on corporate governance and overview of best corporate governance practices in Russia. Besides, the chapter presents literature review of the most relevant sources studying the relationship between different mechanisms of corporate governance and company market value. The second chapter is devoted to methodology description and regression analysis results discussion. Conclusion part includes summarized findings and corresponding managerial implications.

The empirical analysis was conducted using Stata program. The sample comprises companies traded at the Moscow Stock Exchange in 2014 and included in the broad market index. After excluding financial companies and those with insufficient information on the compliance with the Code, 62 companies were retained in the sample. The time period accounts for 2 years (2014 and 2015), since many companies have not published their annual reports for 2016 yet.

In order to conduct the empirical research, both data on compliance with the Code as well as financial data were collected. The data on corporate governance was collected from companies’ annual reports and supplements to them, while financial data was obtained from companies’ financial statements and Thomson Reuters database.

As a result of panel data regression analysis a strong positive association was revealed between the level of compliance with best corporate governance practices and company value. The outcomes of the research can be valuable for both academicians and practitioners. The conclusion part of the paper contains recommendations addressed not only to Russian public companies, but also to regulators of the Russian market.

Chapter 1. Best corporate governance practices and company value

The chapter is dedicated to the overview of corporate governance and best corporate governance practices in Russia and provides literature review of the most relevant sources studying the relationship between different mechanisms of corporate governance and company market value.

1.1. Corporate governance

To start with, let us recall the classical definition of corporate governance provided by Adrian Cadbury. "Corporate governance is the system by which companies are directed and controlled" (Cadbury, 1992). Today more and more companies employ so called value based management approach, which sets value maximization as the main goal for both owners and managers. The concept assumes that a company's aspirations, analytical methods and procedures, compensation systems and management processes aim at value maximization for shareholders by focusing on key drivers of value creation. As interests of managers and shareholders may differ, it is necessary to guarantee that managers take decisions for the benefit of shareholders. Therefore, corporate governance is a system of economic and legal relations, which are the base for corporate control division and cash flows distribution between shareholders, managers and stakeholders.

The problem of corporate governance showed up with the separation of ownership and control within big corporations and the shift from concentrated to dispersed ownership. Today corporate governance is of great importance for big companies, as it focuses on shareholders and investors rights protection, thus increasing company investment attractiveness. Moreover, it contributes to the creation of effective methods for value linked risks assessment and ensures effective usage of funds provided by shareholders.

1.1.1 Agency problem and corporate governance mechanisms

The paper 'The modern corporation and private property' by Berle and Means (Berle, Means, 1932) reveals the separation of ownership and control in corporations with dispersed ownership. As the number of shareholders in such companies is great and they are geographically dispersed, making decisions becomes sophisticated and requires hiring managers who possess appropriate competences and knowledge. Moreover, in order to hedge risks related to a company possible bankruptcy, shareholders prefer keeping a diversified portfolio with various holdings across a number of companies. As a result, the individual owner has no interest in monitoring the day-to-day activities in all of the firms in which he or she has a financial interest (Fama, 1980). All these circumstances give rise to agency relationships. Jensen and Meckling define an agency relationship as “a contract under which one or more persons (or principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent” (Jensen, Meckling, 1976). Taking into consideration that both parties generally tend to maximize their utilities, the agent will not necessarily make decisions which would maximize the welfare of the principal. Therefore, an agency problem in corporate governance introduces the conflict of interests between managers and suppliers of finance.

Asymmetric information is one of the consequences of ownership and control separation. It is a situation when managers possess more complete information about a company rather than owners. Moreover, owners do not have a possibility to fully control all managers’ actions and final results do not reflect the quality of decisions taken by managers. The problem of information asymmetry was raised for the first time in the paper ‘The market for “Lemons”: Quality uncertainty and the market mechanism’ by Akerlof (Akerlof, 1970), where the author investigates the automobile market and states that in some markets only a seller is aware of the product quality; an individual has to purchase the product in order to estimate its quality. Information asymmetry leads to adverse selection problem, when managers become reluctant to provide effective control since investors are less informed. As owners face a risk of poor management, they tend to sign a complete contract on the invested capital management, which states all possible problems the company may face and specifies what actions managers have to take depending on the situation. However, preparation and monitoring of complete contracts requires significant expenses, therefore in practice investors and managers enter into incomplete contracts, which provide main issues concerning their relationships (Libman, 2005). The paper “The nature of the firm” by Coase specifies the existence of transaction costs associated with the formation and execution of contracts and suggests that any firm exists with the aim of transaction costs minimization, while its size depends on the level of reduction of such costs (Coase, 1937).

Jensen and Meckling admit that in most agency relationships the principal and the agent will bear positive agency costs, since it is generally impossible to guarantee at zero cost that the agent acts in the best interests of the principal. The authors distinguish three components of agency costs (Jensen, Meckling, 1976):

– the monitoring expenditures by the principal which comprise costs on writing contracts and controlling their execution as well as on monitoring and evaluating the agent’s actions;

– the bonding expenditures by the agent imply the costs incurred in order to guarantee that the agent will not take certain actions that would harm the principal and to ensure that the principal will be compensated in the opposite case;

– the residual loss which is the amount of the reduction on welfare experienced by the principal due to the interests divergence.

The agency problem is one of the most considerable problems for any modern corporation. According to the research conducted by KPMG, one Russian company in four lost above $1 million because of corporate abuses during the last two years. More than 90% of fraudulent actions from the side of companies' employees are caused by the absence or lack of internal control. Speaking about the types of fraudulent and corrupt actions, in the majority of cases (46%) corporate violators unlawfully appropriate assets or earnings, while both financial statements distortion and passive bribery account for 11% of cases. The research shows that executive directors and members of the board of directors steal in 56% of cases and are followed by functional managers (24%). The results demonstrate that the agency problem remains crucial for Russian companies and leads to significant agency costs. These costs negatively affect the welfare of shareholders; thereby different mechanisms of corporate governance are implemented in order to minimize losses associated with the agency problem (KPMG, 2016).

Corporate governance mechanisms are applied with the aim of resolving the agency problem and decreasing corresponding agency costs. Internal, organizationally based mechanisms of corporate control and external, market-based control mechanisms can be employed to help align the diverse interests of managers and shareholders (Walsh, Seward, 1990). Internal mechanisms comprise the effective board of directors, executive incentives and ownership concentration, while external mechanisms include the stock market and market for corporate control (Berezinets, Ilina, Cherkasskaya, 2013). It is worth to highlight that external mechanisms are the tool of last resort, since they are used when internal control efforts are not efficient.

According to Agrawal and Knoeber, four broad mechanisms work to provide incentives to managers and so alleviate the agency problems between managers and shareholders. Three of them rely on parties outside the firm to monitor managers. They are the use of debt, which allows evaluating a manager's performance based on capital market, the labor market for managers and the market for corporate control. The fourth mechanism, monitoring by the firm's own large shareholders and board members, is a source of another agency problem: Who monitors the monitors (Agrawal, Knoeber, 1996)? The authors suggest the following solutions:

more concentrated shareholdings by insiders, more concentrated ownership by outside blockholders or by institutions and the market for directors.

1.1.2 Corporate governance in Russia

Taking into consideration that public companies are obliged to follow the current legislation of Russian Federation, it seems necessary to give a description of the main elements of corporate governance in accordance with the Federal Law “On joint-stock companies”.

Board of directors: role, functions, structure

The board of directors (or supervisory board) is a collegiate body that carries out general management of the company and functions under the authority given by the law and corporate charter (On joint-stock companies, 1995). Any joint-stock company with the number of shareholders exceeding 50 is required to have the board of directors. The responsibilities of the board of directors may be divided into several functional groups:

- the duties on general company management;
- the duties concerning the charter capital and corporate property;
- the duties related to the transparency and information disclosure;
- the responsibilities dedicated to the shareholders rights protection (Berezinets, Ilina, Cherkasskaya, 2013).

Members of the board of directors are elected by the general meeting of shareholders, and the number of members is identified by the corporate charter or by the general meeting of shareholders, but may not be less than five. If the company accounts for more than one thousand shareholders with voting rights, the minimum amount of members is seven, and in case when the number of holders of voting stock exceeds ten thousand, the board of directors should include no less than nine members. Moreover, the right to nominate candidates to the board of directors is retained only by shareholders possessing no less than 2% of voting shares. Members of the collective executive body should not account for more than 25% of the seats on the board of directors.

The recent research by PricewaterhouseCoopers analyzes the opinions of over 70 members of the boards of directors representing more than 200 Russian joint-stock companies. The main conclusions state that on average the board of directors of the 50 biggest Russian public companies is represented by ten members, four of them are independent. The study emphasizes that the role and importance of the board of directors and especially independent directors have increased significantly. Today directors deal with sophisticated challenges and have an opportunity to create the value and affect the company performance, at the same time the level of professionalism of the board increases. 20% of the 50 biggest Russian publicly traded companies report having an independent director as the chairman of the board (PwC, 2012). Another survey focuses on the identification of the main tendencies and priorities in the work of the board of directors. More than half of respondents represent companies with the annual revenue higher than $1 billion. According to the survey, the most foreground issues that directors would like to pay much attention to are risk management, strategic planning and management compensation. In addition, directors put great store on the information interaction with shareholders and stakeholders (PwC, 2012).

The more recent study by PwC examines responses of board members of 163 Russian companies. Since the survey was conducted in crisis, 83% of companies were reconsidering their strategies taking into account such factors as ruble devaluation, limited access to capital due to sanctions and more severe rivalry. According to the survey, the most relevant competencies that board members should demonstrate are industry (92% of participants), risk management (81%), financial (81%) and technology (77%) experience (PwC, 2015).

Executive compensation

Creation of the effective remuneration systems helps resolve the agency conflict by providing managers with incentives that fit interests of shareholders. As the Law "On joint-stock companies" states, decisions on the compensation of the board of directors are made by the general meeting of shareholders. The main issues widely discussed in both academic and practical contexts are the size of compensation and factors that determine it.

Generally, remuneration of the board of directors and key managers include short-term payments represented by salaries and annual bonuses, and long-term compensation generally linked to indicators reflecting long-term company performance, as well as severance payments and pension benefits. As for the board of directors, only non-executive directors are rewarded. In some companies directors are paid for each meeting of the board where they take part. In order to stimulate executives to pursue long-term goals, such as market capitalization increase, shares and options are used as rewards. However, this approach of executive stimulation is not broadly implemented in Russia. One of the companies applying this type of compensation is OJSC "Rosneft" where independent directors get payments in the form of the company shares.

Still, remuneration systems in Russian companies differ significantly. Therefore, big public companies employ performance-based models accepted in western countries, while smaller companies do not often tie management compensation to financial indicators and long-term performance and pay out fixed salaries.

Risk management and internal control

The role of internal control is difficult to overestimate. The Institute of Internal Auditors defines internal auditing as "an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes" (The Institute of Internal Auditors). Internal audit is a provider of information to the board of directors and management, in particular, it informs about internal and external risks the company faces, cases of fraud and violations in the company and other important problems that may influence the company performance. Being a reliable source of information, internal audit eliminates the information asymmetry.

Three approaches exist to establish the internal audit in the company. First of them is to create the own internal auditing system which benefits the company, since employees are acquainted with the processes inside the company and industry peculiarities, and they can accumulate knowledge and keep it confidential. The second approach is to use outsourcing, in other words, to delegate the rights of auditing to the external company. The third approach is known as co-sourcing and assumes a combination of the previously discussed approaches. The advantages of co-sourcing and outsourcing are the availability of experts in different fields as well as advanced technologies.

1.1.3 Main principles of the Code of Corporate Governance

The early 2000s were a period of rapid growth of the Russian economy, characterized by improvements in the performance of Russian companies and subsequent growth of share prices, as well as increasing number of securities issuers. As a result, investors became more interested in putting money in Russian companies, which facilitated corporate governance practice development. The Russian legislation on joint-stock companies was poorly developed then and frequent violations of the rights of minor shareholders and investors were undermining confidence in Russian companies. Therefore, the Central Bank of the Russian Federation developed the Code of Corporate Behavior, which provided companies with the guidelines on how to embed best practices of corporate governance taking into account peculiarities of the Russian legislation and formed relationships between shareholders, members of the board of directors, executive bodies, employees and other stakeholders. The Code increased the involvement of shareholders and investors in the performance of companies. Many companies started using the Code as a base for the development of internal documents on corporate governance. Consequently, the Code refined corporate governance in Russian public companies and promoted international standards, which resulted in the increase of investment attractiveness of the Russian economy.

The financial crisis happened in 2008 revealed weaknesses of the Russian corporate governance system and proved the importance of corporate governance in providing sustainable company development. Speculative investors, prevailing on the Russian market during the period of 'catch-up' growth, lost their interest in Russian companies. This circumstance stimulated Russian companies to attract long-term investors, which was possible only in case of guarantees that their rights would not be violated. Therefore, the necessity of the Code revision brought to the issuance of the Code of Corporate Governance in 2014. The Russian Code of Corporate Governance is a document providing public companies with standards and recommendations on corporate governance mechanisms implementation. The Code consists of two parts: the principles of corporate governance and recommendations on seven elements of the corporate governance system. Let us briefly discuss the main provisions suggested in the Code.

Shareholders' rights and equality of conditions for shareholders in the exercise of their rights

This chapter suggests recommendations concerning shareholders' rights observation in terms of general meeting participation and profit distribution in the form of dividends payout, suggests the equality of conditions for all shareholders who own the same type of shares including minor shareholders and foreign investors. A company should create favorable terms for shareholders to get prepared and take part in the general meeting, provide them with an opportunity to use their rights, namely to vote in a convenient way and propose candidates to the board of directors. Moreover, the procedure of dividends nomination shall be transparent and clear, while the company should pay out dividends in case when it is economically expedient. The Code recommends companies to build conditions which facilitate decent treatment of each shareholder by governing bodies and controlling persons and prevent abuses from the side of major shareholders.

The board of directors

This chapter is the broadest in the Code, which emphasizes the role of the board of directors in corporate governance. The Code mentions that the board of directors shall monitor management and be accountable to shareholders by disclosing information about its work. Being a mediator between two parties, the board of directors plays a significant role in resolving the agency conflict. The board exercises strategic management of the company, defines approaches for risk management and internal control, tracks execution of the principles of information transparency and disclosure, smoothes conflicts in the company and oversees compliance with the corporate governance practice. Since the board bears serious responsibilities, its members shall possess perfect reputation and sufficient knowledge and skills. Rights and responsibilities of the board shall be specified in internal documents of the company.

Election of members of the board of directors should be held as a transparent procedure, which takes into consideration the variety of shareholders' opinions and accounts for legislative requirements and the company objectives. Moreover, shareholders should be provided with the complete information about candidates to the board and executive bodies.

The quantitative composition of the board should contribute to its effective work and creation of directors committees. The Code recommends including enough independent directors in the board, who are capable of making objective judgments not affected by interested parties. A candidate connected with the company, its major shareholder, contractor, competitor or the government, is not considered independent. In particular, a person who has been a member of the board for more than 7 years cannot be chosen as an independent director. The Code suggests that independent directors shall account for no less than one third of the board members.

The Code also regulates election of the chairman of the board. It is suggested to assign an independent director as a chairman or choose a senior independent director who controls other independent directors and communicates with the chairman.

Boards are advised to form committees responsible for preliminary consideration of the most relevant issues and preparation of recommendations to the board. The Code emphasizes the importance of audit, remuneration, nomination and strategy committees with each committee being represented by at least 3 members. Audit and remuneration committees should be composed of only independent members, whereas nomination committee is supposed to include mainly independent directors and can be combined with the remuneration committee.

The Code also makes recommendations on the board assessment. Thus, the assessment shall be held on a regular basis, but at least once in a year, while the effectiveness of each member and committee as well as the board itself shall be evaluated. Moreover, at least once in three years the assessment shall be made by the external organization (consultant).

Corporate secretary

The Code encounters responsibilities of the company secretary which comprise efficient interaction with shareholders, shareholders rights and interests protection control as well as the maintenance of the efficient work by the board of directors. The recommendations are related to the field of education, work experience, knowledge and competences of the company secretary. In particular, the secretary shall possess a degree in the field of law, economics or business along with two years of work experience in corporate governance. Besides, the secretary shall be independent from the company executive bodies and all the information about him shall be disclosed on the company website. Among all the recommendations suggested by the Code, the Moscow Exchange stresses out the criterion specifying that the secretary should not perform other functions in the company.

System of remuneration for the board members, executive bodies and other key managers of the company

Companies shall adopt its internal remuneration policy and pay out compensations in accordance with it. At the same time, the amount of compensation should be optimal, which means that it is enough to motivate the board members, executive bodies and key managers to work effectively, but not overvalued, and there is no huge gap between the levels of compensation for them and other employees. The remuneration policy should be developed by the remuneration committee and approved by the board of directors and should provide clear procedures for compensations identification. Speaking about the board of directors, the members are recommended to receive fixed annual payments regardless of how many meetings they attend. Short-term motivation is not desirable, as the system of remuneration is supposed to bring together the interests of shareholders and board members. From the viewpoint of the Code, compensations paid out in the form of company shares incline members of the board to pursue long-term objectives. In case of management the compensation consists of both fixed and variable components. Namely, a variable part of the compensation should be based on the company performance and a manager’s own contribution. Publicly traded companies are advised to introduce programs of long-term motivation of executive bodies and key managers which assume shares and derivatives usage.

Risk management and internal control system

The board of directors should be responsible for the identification of approaches for risk management and internal control in the company. In order to systematically assess the reliability and efficiency of the risk management and internal control system, companies are recommended to introduce a separate internal audit subdivision or engage an independent organization. Moreover, a functional part of the internal audit subdivision should be subordinated to the board of directors, while an administrative part should report directly to the executive body. It is highly recommended to implement an anti-corruption policy, which creates the elements of corporate culture, organizational structure and procedures aimed at the prevention of corruption. The Code states that companies also should form a separate subdivision dealing with risks management and internal control.

Disclosure of information about the company and its information policy

A company and its activities should be transparent for shareholders, investors and other interested parties. The company is advised to develop the document defining its information policy, which includes a website where frequent shareholders and investors questions are answered and relevant information is placed, regular meetings of executives with analysts and executives presentations concerning financial performance, strategic development of the company and other important issues. Public companies are recommended to disclose the information on corporate governance and in particular on compliance with the Code. If a substantial part of the company shareholders are foreign, the most important information about the company should be disclosed in English. Information policy realization should be held by executive bodies, while its monitoring is assigned to duties of the board of directors. Companies are suggested to disclose the information on financial results in accordance with accounting standards along with the information related to the board of directors, capital structure and its major controlled legal entities. Shareholders who possess the same amounts of voting shares should be given equal rights to address the information and documents of the company. Annual reports, being the most important tool of communication with shareholders and other interested parties, should incorporate additional information on corporate governance, for instance, a report by the board of directors, remuneration policy description with figures on each board member and executive as well as the company CEO, information on the direct or indirect shares ownership. Undertaking all the listed actions contributes to the company transparency enhancement.

Major corporate actions

Actions that noticeably affect or can affect capital structure or financial health of the company and consequently influence shareholders welfare are defined as major and should be executed in fair conditions and in compliance with the interests of shareholders. The company charter is supposed to define the list (criteria) of deals and other major actions which are reviewed by the board of directors. The board of directors is recommended to make decisions and suggest recommendations regarding major corporate actions based on independent directors opinions. Shareholders should be provided with all the information about major actions in a timely manner and as a result be able to influence their execution. According to the Code, major corporate actions include company reorganization, acquisition of 30 or more percent of voting shares (takeover), making major deals, increase or decrease in the company share capital, listing or delisting of shares and other actions that may lead to serious changes in shareholders rights or violation of their interests.

1.1.4 Implementation of the Code in Russian public companies

The government made the compliance with the Corporate Governance Code mandatory for 13 state-owned companies from September 1, 2014. The approved list of companies comprises VTB, Sberbank, ALROSA, Aeroflot, Russian Railways, ROSSETI, RusHydro, Sovkomflot, Transneft, Rosneft, Gazprom, Rostelecom, and FSK EES. It was assumed that starting from 2015 the companies would form boards of directors with at least one third of members being independent (Butrin et al., 2014). However, not all the companies strictly followed the provisions in 2015: among 11 members of the board of directors in Gazprom only 2 were independent till December 22, 2015. According to the analysis by the experts of the Open Government, Gazprom and FSK EES demonstrate poorer performance compared to other companies from the list (Papchenkova, Bazanova, Mahneva, 2016).

The research by Deloitte reveals that corporate governance in Russia has not advanced since 2012. Investors lost their interest in shares of Russian companies because of sanctions and oil and gas prices drop. Consequently, Russian companies became more reluctant to the implementation of best practices of corporate governance. The survey covers 120 Russian public companies with 34 of them being directly or indirectly controlled by the government. The results show up that the average percentage of independent directors has not change since 2012 – it still remains equal to 27%. It can be explained by the weakening influence of foreign investors and the renewed practice of appointing senior officials to boards instead of independent in 2014 and 2015. Deloitte estimates that no more than 41% of companies in the sample meet the requirement on having 33% share of independent directors on the board. Boards of directors in Russian companies are mainly in charge of the strategy execution supervision, while the strategy identification itself is delegated to strategy committees. Thus, strategy committees are present in 53% of companies, while in the US the proportion is only 3% (Deloitte, 2016). According to the Code, companies are recommended to shape audit committees from independent directors. Nevertheless, only 23% of companies are in line with this provision, and 19% of companies have audit committees with no outside directors. In addition, some companies assign top-managers to remuneration and nomination committees, which seems at least weird: they set their own salaries. As for the assessment of the board of directors, 16% of respondents reported on holding self-assessment by the board, and only 6% engaged external companies for this purpose. On average, the figures reflecting the quality of corporate governance in Russian companies are almost the same as in 2012, when the first corporate governance survey by Deloitte was conducted.

The survey by PwC examines companies' compliance with the Code provisions. Only 8% of directors state that corporate governance practices in their companies are fully in line with the Code provisions, while 51% of companies claim that they are currently working on the Code adoption, 17% of respondents are planning to start implementing the recommendations in the nearest future, and 24% are not considering this option at all. Despite the fact, that companies show such modest results, 83% of directors strongly believe that adoption of the Code could increase companies' investment attractiveness at least in long-term and medium-term perspective (PwC, 2015).

The Central Bank of Russia initiated monitoring the compliance of Russian public companies with the Code in 2016 and published the review on the basis of companies' annual reports for 2015. The bank is going to prepare such reviews once in a year in order to push more companies to implement the Code by demonstrating fruitful results of progressive companies, improve the market transparency, and break the stereotype among investors about insufficient level of corporate governance in Russia. The review rests on 84 companies listed on the Moscow Exchange and included in the first and the second quotation levels. The results suggest that the average level of compliance with the Code is 58% in 2015. The minimum percentage of observed principles is 16.5%, while the most advanced company states its compliance with 97.5% of recommendations (Central Bank of Russia, 2017). The results of the analysis are presented on Figure 1.

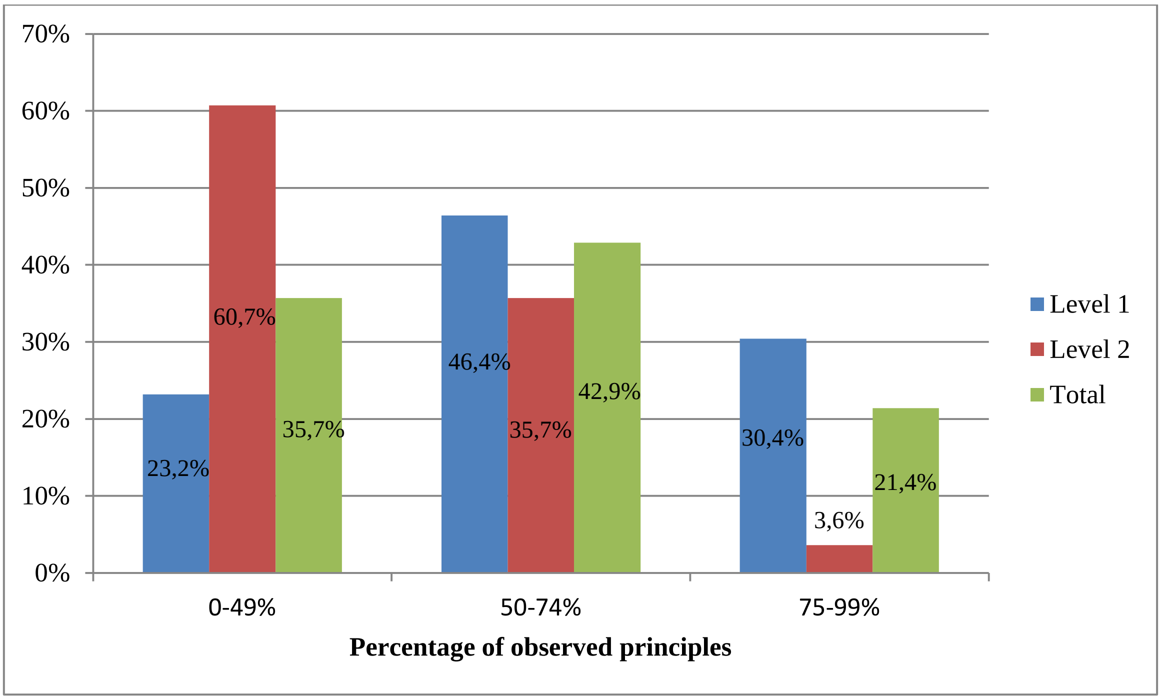

Figure 1. Distribution of companies according to the level of compliance with the Code Source: Central Bank of Russia, 2017

The Moscow Exchange started introducing changes in the listing in 2014: in order to be included in the certain quotation level, companies have to meet requirements on corporate governance, in particular, provide financial reports in compliance with IFRS, have sufficient percentage of independent directors on boards, form audit, remuneration and nomination committees, and others. The transformation will be finished by the end of 2018, when the requirements from the side of the Moscow Exchange will fully correspond to the Code. Some companies are not able or have no necessity to follow the requirements and have to leave quotation levels. For instance, Rosseti made an effort to bring corporate governance in its subsidiaries in line with the Moscow Exchange requirements in 2016. However, since minor shareholders were not interested in nominating enough independent directors to boards, 5 subsidiaries of Rosseti had to move to the second quotation level on January 31, 2017 (Lomskaya, Usov, 2017).

1.2 Corporate governance and company value: literature review

“Value is a particularly helpful measure of performance because it takes into account the long-term interests of all the stakeholders in a company, not just the shareholders” (Koller, Goedhart, Wessels, 2010). In general, the value of a company is determined by its discounted future cash flows (Koller, 1994). There are two common measures of company value: book (accounting) value and market value. Book value relies on the company financial statements and thus represents its past performance, while market value is based on the information provided by the market and thus reflects investors' expectations. Market value can be represented by market capitalization, which is defined by multiplying the number of outstanding shares by the current share price. In order to obtain the relative estimation of company value, researchers implement ratios based on both accounting and market data.

The Tobin's Q ratio is regarded as one of the most demanded indicators for the estimation of securities market attractiveness. Generally the ratio is calculated as the market value of a company divided by the replacement value of its assets (Bodie, Merton, 2007). The Q ratio demonstrates how efficiently the company manages its assets. For instance, in case of inefficient management the company market value will be smaller than its assets value, and the ratio will be quite low (less than 1) (Damodaran, 2002).

Despite the wide application of the Q ratio in academic papers for a company value assessment, researchers note that its implication as a tool for analysis is quite sophisticated. Particularly, the study "A simple approximation of Tobin's q" stresses out the complexity of the previously developed procedure by Lindenberg and Ross (Linderberg, Ross, 1981) and suggests an approximation of Q which was empirically tested and was proved to be strongly correlated with Q derived from the more theoretically correct Lindenberg and Ross formula (Chung, Pruitt, 1994). The approximate Q is calculated as follows:

$$Approximate\ Q = \frac{MVE + PS + DEBT}{TA}, \tag{1}$$

where MVE is market value of equity, PS is the liquidating value of a firm's outstanding preferred stock, DEBT is the sum of the firm's short-term and long-term liabilities net of its current assets, TA is the book value of total assets (Chung, Pruitt, 1994).

The advantage of using the Tobin's Q ratio is that it rests on both accounting and market data (Berezinets, Ilina, Cherkasskaya, 2013). Tobin's Q, being a market-based measure of firm value, reflects the market's expectations of future earnings and is a good proxy for a firm's competitive advantage (Montgomery, Wernerfelt, 1988). Moreover, it accounts for risks and is not affected by reporting distortions (Lindenberg, Ross, 1981).

Since the goal of the research is to investigate the relationship between the compliance with best corporate governance practices and company value, let us review sources of literature studying relationships between various characteristics of corporate governance and company value.

The board of directors

Academicians often consider the board of directors as the main mechanism of corporate governance responsible for monitoring. The board possesses more complete information than shareholders and is more powerful in terms of decision-making, thus being a mediator between managers and shareholders.

The size of the board is one of its key characteristics. The issue of advantages and disadvantages of big boards was discussed by many researchers (Lipton, Lorsch, 1992; Coles, Daniel, Naveen, 2008; Larnou, Vafeas, 2008). Let us consider the issue applying the agency theory, which states that the core duty of the board is to monitor top-management, since there might be possible conflicts between managers and owners. Does the board size affect the quality of monitoring? If the answer is positive, we may assume that the influence can be quite different. On the one hand, big boards can better monitor top-management, since they include a greater number of "monitors". On the other hand, there is a high probability of internal conflicts on big boards, therefore small boards can be more efficient.

The analysis of panel data collected on the US companies (Yermack, 1996) reveals that companies with small boards of directors have higher market value represented by Tobin's Q and demonstrate better financial performance. The authors of another academic paper investigating small and midsize Finnish firms admit that the board-size effect takes place even in small firms and suggest that a negative correlation exists between the board size and firm's profitability (Eisenberg, Sundgren, Wells, 1998). Despite the fact that many papers establish that companies with small boards have advantage over those with big boards, there are some articles setting forth controversial results. For instance, the work (Kiel, Nicholson, 2003) investigating top Australian publicly listed companies displays that the market rewards companies with larger boards, which resuts in higher values of Tobin's Q.

The article (Coles, Daniel, Naveen, 2008) raises a question of why despite a lot of research proving small boards to be more preferable there are still companies with big boards of directors. The authors state that big boards might be less effective suffering from a lack of coordination. Putting the question, the authors assume that for diversified companies and highly leveraged companies big boards may be valuable in terms of performing as "advisors" for CEO. The analysis of descriptive statistics of American companies shows that boards of diversified companies have 15% more members compared to companies focusing on a single industry. Moreover, the researchers found out that big boards corresponded to companies with the level of leverage higher than median. The regression analysis confirmed the assumption that for diversified and highly leveraged companies correlation between the board size and Tobin's Q is positive, in the opposite case the relationship is negative. Therefore, the paper concludes that the relationship is nonlinear, and small and big boards are more efficient than midsize ones.

The research on the sample of Russian companies (Berezinets, Ilina, Cherkasskaya, 2013) finds out a nonlinear association between the board size and Tobin's Q and comes up with the same finding as in (Coles, Daniel, Naveen, 2008). The authors interpret the results in the following way: the market perceives small boards as highly efficient from the viewpoint of monitoring function execution, at the same time companies with big boards of directors are efficient from the resource dependence theory perspective, since the more members the board consists of, the more access to external resources it has. Therefore, the association between the board size and company value for Russian companies is U-shaped.

Another characteristic of the board widely discussed in the literature is board diversity. In its broadest sense, diversity accounts for differences in gender, age, physical abilities, qualities, and sexual orientation, as well as for differences in attitudes, perspectives and background. It is believed that more diversified boards demonstrate a better perception of the marketplace, carry out more innovative and creative solutions. Moreover, diversity provides more effective corporate leadership and global relationships (Robinson, Dechant, 1997). Therefore, it is assumed, that board diversity somehow affects short-term and long-term performance and company value.

The study "Corporate Governance, Board Diversity, and Firm Value" examines whether the board diversity is associated with improved company value for publicly traded Fortune 1000 firms (Carter, Simkins, Simpson, 2003). The authors aim at finding out whether board diversity affects board independence and thus allows better monitoring of management. By the term diversity the researchers understand gender, cultural and racial composition of the board. The model employed in the research accounts for different characteristics and includes financial data such as firm size represented by the logarithm of its total assets and return on assets. The measure of firm value is the approximate Tobin's Q, calculated in accordance with (Chung, Pruitt, 1994). The authors discover that the presence of women or minorities on board is positively correlated with firm value. They conclude that there is a positive relationship between the board diversity and firm value.

There is a significant amount of articles studying the impact of gender diversity on different firm characteristics and particularly on its value. This interest is explained by the trend of including more women in board members that is clearly seen during last years. Some countries even have certain requirements for the number of women on boards from the side of government, for instance, Spain, Island, France, Finland and Norway (Smirnova, 2011).

The paper (Torchia, Calabro, Huse, 2011) demonstrates that Norwegian companies with at least three women on boards generally have higher level of organizational innovation. These companies are more apparently to create and adapt new ideas and models of company behavior, including introduction of innovative company management systems and business practices as well as innovations promotion due to optimization of organizational structure and human resources development. In this case gender diversity of the board can provide the company with a competitive advantage. Also gender diversity can positively affect the company profit management (Arun, Almahrog, Ali Aribi, 2015).

Compared to male members of the board, women are more responsible in terms of participation in the board meetings, they often become members of committees, executing the monitoring function (Adams, Ferreira, 2009). Women usually consider different points of view, which results in more effective decision-making. Besides that, women are more diligent in the issues of preparation for meetings, assessment of their individual work, and identification of opportunities for improvement (Huse, Solberg, 2006). The paper (Croson, Gneezy, 2009) states that women are more risk-averse than men and less willing to be involved in competition.

The article (Campbell, Minguez-Vera, 2008) investigates the relationship between gender diversity and company value in non-financial companies listed on the continuous market in Madrid. According to the results, the percentage of women presented on board is positively related to approximate Tobin's Q. The investigation of companies from Fortune 1000 list comes up with the same conclusion (Adams, Ferreira, 2009). However, the analysis of Danish firms does not find any influence of gender diversity on financial performance measured by Tobin's Q (Rose, 2007). The possible explanation of the findings carried out by the authors is that female board members might adopt the behavior of male members in order to be qualified by top decision makers. As a result, the gender gap between board members is blurred. Thereby, academic papers reveal quite controversial findings, but the majority of them state that the presence of women on board positively affects the company's long-term performance.

A major part of research papers is dedicated to the issue of board independence. Directors who are not connected with management are supposed to take independent and rational decisions taking into consideration shareholders' interests. According to the agency theory, boards that are composed of insiders and dependent non-executive directors have no incentives to protect shareholders' interests in case they differ from managers' interets. Only outsiders are capable of more effective control over management actions (Fama, Jensen, 1983). The stewardship theory does not support the opinion that independent directors should dominate and assumes that top-management has better understanding of the situation in the company and is more competent in decision-making (Donaldson, Davis, 1991).

The board independence is defined by the firm individual characteristics, such as size, age and number of business segments the company operates in. As the firm grows and increases its assets portfolio, the percentage of independent directors on board also tends to grow (Boone et al., 2007). The paper (Rosenstein, Wyatt, 1990) observes that if the company with a considerable number of independent directors on the board includes one more independent director, its value will increase. However, these results do not mean that executive directors are less valuable than independent. At the same time some researchers show that independent boards do not deliver any financial benefits to shareholders (Dalton et al., 1998; Bhagat, Bolton, 2008), while others furthermore state that companies with boards composed of insiders demonstrate better financial performance (Kiel, Nicholson, 2003; Drakos, Bekeris, 2010). The negative association between the share of independent directors and company market value represented by Tobin's Q was found in the paper (Christensen, Kent, Stewart, 2010) studying Australian companies. As for Russian companies, the model of empirical research applied in (Berezinets, Ilina, Cherkasskaya, 2013) turned out to be insignificant, which means that no correlation between approximate Tobin's Q and board independence was detected.

Management compensation

Jensen and Meckling (1976) state that management compensation structure is affected by the company business nature, defined by the level of risk, firm size and other factors. Mehran argues that it is the form, not the amount of compensation, which motivates managers to increase company value (Mehran, 1995). The researcher also shows that firm performance proxied by Tobin's Q is positively associated with the share of equity-based management compensation and the percentage of equity owned by managers. Since the information on management compensation is usually not disclosed, there are much less research papers devoted to this mechanism of corporate governance investigation than articles related to the board of directors.

Some academicians study the relation between managerial ownership and firm market value. The analysis of the US companies finds that a positive relation exists between managerial ownership and Tobin's Q in the ownership range of 0% and 5%, as well as for the level of ownership higher than 25%, while in the range of 5% and 25% the association is negative (Morck, Schleifer, Vishny, 1988). The results are in line with Jensen and Meckling (1976) who suggest that high level of managerial ownership helps link interests of management to those of shareholders. The paper (Short, Keasey, 1999) suggests the existence of a non-linear association between company performance measured both as accounting and market, and percentage of shares held by managers for the UK firms.

CEO compensation practices opposers claim that the board of directors define the CEO’s compensation in such a way that it is not always aimed at shareholders’ value maximization, since it is affected by the CEO (Core, Holthausen, Larcker, 1999). According to Jensen and Murphy, there is no significant correlation between the CEO compensation level and shareholders’ wealth, while long-term management compensation program, which assumes rewarding managers with company shares and options, is the most efficient from the viewpoint of company value maximization (Jensen, Murphy, 1990).

Internal control and audit

The importance of internal control and audit system in the company is not questioned nowadays. There is an increasing attention paid to internal audit as a part of financial management and its influence on financial performance and company value. However, not so many articles consider this mechanism of corporate governance. Internal audit processes make a significant contribution to the strategy imlementation and goals achievement within the company. Moreover, internal audit department supports management and audit committee (Hutchinson , Zain, 2009).

Some researchers study the size of audit committees and come up with conclusion that too big committees are characterized by poorly allocated responsibilites and low efficiency. According to Jensen (1993), the optimal size of audit committee is 7-8 members, because in this case discussion process is the most productive and problem solution is weighted.

Professionalism, experience and qualification of the committee head and members are considered to be positively related to financial performance of the company (Hilman, Dalzier, 2003; Hutchinson , Zain, 2009).

To sum up, there is a decent number of papers studying different mechanisms of corporate governance and the impact they have on company performance and value, but the board of directors is discussed especially widely. In particular, the board independence is of great interest today, since independent directors are believed to carry out independent and objective decisions aimed at shareholders’ value maximization.

The level of information disclosure

Information openness is one of the main attributes of superior corporate governance helping resolve the information asymmetry problem. Since shareholders of a company can be geographically dispersed, the company website plays an important role in information transfer. The problem importance is explained by a huge amount of empirical research related to the issue of information disclosure and its influence on company performance and value.

The analysis of 150 public companies which shares are traded on the stock exchanges of Brazil, Mexico and Argentina suggests that Tobin's Q is mostly affected by the industry and company size, while the level of information disclosure weakly influences company value, though this variable is statistically significant (Silva, Alves, 2004). The paper by Firth (Firth, 1979) demonstrates that big companies are more likely to disclose information. According to Liu and Eddie, Chinese companies with foreign shareholders disclose more information than those having only domestic investors (Liu, Eddie, 2007). The authors employ the disclosure index, constructed on the basis of 147 criteria and suggest that companies with high return on equity (ROE) are more reluctant to disclose information. Moreover, introducing international auditors makes companies disclose more information. As for Chinese companies with domestic investors only, companies with more concentrated ownership have a higher level of information disclosure. The researchers explain the latest findings by the prevailance of state ownership in the major part of the sample, which motivates companies to provide transparent and reliable information in order to increase the level of public trust.

The article studying Russian companies considers return on sales (ROS) as a measure of company performance (Berezinets, Ilina, Orlova, 2009). The sample includes 64 companies with most of them being unlisted. The authors build the disclosure index using 22 criteria divided into 4 categories: information about corporate governance, financial information, easy access in the Internet, and information about company's activities. As a result, no correlation was found between the level of information disclosure and company performance represented as ROS.

Though the problem is widely discussed in the literature, a major part of research papers do not reveal significant influence of the level of information disclosure on company financial performance and value.

1.3 Corporate governance index construction

Besides academic papers investigating relationships between specific corporate governance mechanism and company value, scholars also consider the corporate governance system as a factor that affects company value. For this purpose researchers create corporate governance indices, which characterize the quality of corporate governance in general. There is a huge amount of different indices and rankings constructed in order to provide companies with an incentive to endorse better practices and an opportunity to differentiate them in the market. Governance indices allow raising standards in companies and increasing investors' awareness about them. Nowadays governance indices are constructed by stock exchanges (for instance, Corporate Governance Index by Shanghai Stock Exchange or FTSE Italia STAR by Borsa Italiana), ranking agencies or investment banks. However, rating results are rarely disclosed, because companies are reluctant to have their rating revealed, while the access to methodologies of indices calculation employed by the listed organizations remains a challenge (Grimminger, Benedetta, 2013).

Since the level of compliance with the Code is measured by the index of corporate governance, it is necessary to pay special attention to the articles where different indices of corporate governance are built and study the existing methods of their construction.

The authors of one of the most cited papers dedicated to the corporate governance index construction (Gompers, Ishii, Metrick, 2003) use 24 governance rules divided into five thematic groups and assign points according to the following rule: for every firm, they add one point for each provision that deteriorates shareholder rights. Consequently, companies with higher corporate governance index are referred to as having "weakest shareholder rights". The authors also build subindices for each of the five categories. It is worth to note that the model implemented in the article does not assign any weights to the thematic groups, the index is calculated as a sum of points appointed for each rule.

The paper (Black, Love, Rachinsky, 2006) considers six corporate governance indices from five different providers: two major investment banks, one rating agency, and two nonprofit Russian organizations. The authors convert each index to standard normal form with higher scores demonstrating better governance. In order to build the combined index, 6 standardized indices are incorporated. Not all the companies disclose their methodologies, so the authors allocate weights to subindices subjectively.

The study (Klapper, Love, 2003) refers to the report by Credit Lyonnais Securities Asia (CLSA) where the index with corporate governance ranking for 495 firms in 25 countries was calculated. The CLSA questionnaire includes 57 qualitative, binary questions on 7 categories: management discipline, transparency, independence, accountability, responsibility, fairness, and social awareness. By answering "Yes" a company added one point to its governance score in each section. The authors estimated the percentage of positively answered questions for each category and calculated the governance index as the average of the six categories with the social awareness category being excluded. As it is stated in the paper, social awareness is not relevant for corporate governance.

The article "Does Corporate Governance Predict Firms' Market Values? Evidence from Korea" investigates corporate governance in 515 Korean companies (Black, Jang, Kim, 2006). The authors construct a Korean Corporate Governance Index (KCGI) based on the survey by the Korea Stock Exchange using 38 elements. The variables are split in 4 subindices: shareholder rights (5 elements), board structure (4 elements), board procedure (26 elements), and disclosure (3 elements). The fifth ownership parity subindex which exhibits the extent to which the largest shareholder controls more votes than he directly owns is introduced by the authors. In order to build KCGI, the authors first sum up a firm's score on the nonmissing elements of each subindex, divide it by the number of those elements, and multiply the ratio by 20. As a result, each subindex lies in the interval between 0 and 20 and KCGI being the sum of the subindices can have values from 0 to 100. Therefore, companies with the advanced corporate governance have higher scores.

The academic paper "Corporate Governance and Firm Value: International Evidence" describes the procedures of construction of two different additive corporate governance indices (Ammann, Oesch, Schmid, 2011). Both indices rely on 64 individial governance attributes, however, the authors assign equal weights to each attribute while constructing the first index and employ a principal component analysis (PCA) to derive the second index. Corporate governance attributes are provided by Governance Metrics International (GMI) and sub-categorized into the following groups: board accountability, financial disclosure and internal control, shareholder rights, remuneration, market for control, and corporate behavior. The first index reflects the percentage of attributes adopted by a company. In other words, the authors give one point for each attribute a company has in place and zero otherwise. Speaking about the second index, since PCA requires does not deal with unbalanced data, number of attributes was restricted to 17. As a result of PCA application the authors set the index equal to the first principal component, which explains 16.4% of total variance. While conducting the robustness tests, the researchers also use alternative approaches to PCA implementation. Thus, in the first approach five components that explain 51.3% of total variance are used and inserted in the regression. The second approach assumes setting the link between each component and a governance attribute with a factor loading higher than 0.4 in absolute value. The indices are calculated as equally weighted averages of standardized values of the associated governance attributes. The PCA approach was also employed by Larcker, who argues that PCA-based corporate governance index has smaller measurement error than indices with equally or subjectively assigned weights of components (Larcker, Richardson, Tuna, 2007).

Chapter 2. Empirical study of the relationship between the level of compliance with best corporate governance practices and company value

This chapter provides an empirical analysis of the relationship between the level of compliance with best corporate governance practices and company value. The chapter comprises research objectives and hypothesis formulation, methodology and sample description, as well as descriptive statistics of employed variables.

2.1 Hypothesis statement and methodology

Based on the literature review on corporate governance, it is possible to distinguish two groups of research papers: the first group studies the influence of one or several distinct mechanisms of corporate governance on company value, while the second group investigates the relationship between corporate governance in common and company value building corporate governance indices. Taking into account that the majority of papers discussed in the previous chapter argue that firms with higher quality of corporate governance have higher market value, we can formulate a hypothesis which will be tested in this chapter:

H_1: There is a positive relationship between the level of compliance with best corporate governance practices and company market value for Russian public companies.

2.1.1 Model description

In order to test the hypothesis, the panel data regression was constructed. The methodology is implemented by many researchers studying corporate governance. Since the goal of the research is to investigate the relationship between the level of compliance with best corporate governance practices and company value, it was necessary to select the dependent variable representing company value and control variables that define it. It was decided to take market ratio as a proxy of company value, since market ratios are directly connected with shareholders' wealth growth and thus better reflect the quality of corporate governance in the company. Based on the broad literature review, Tobin's Q was chosen as a ratio which reflects company market value. The advantages of the ratio are discussed in the first chapter.

The econometric research is based on the following regression model:

$$TQ_i = \beta_0 + \beta_1 CGI_i + \beta_2 Size_i + \beta_3 Lev_i + \beta_4 Bidask_i + \varepsilon_i, \quad (2)$$

where TQ_i – Tobin's Q for company i, where i=1,2,3…N;

CGI_i – level of compliance with best corporate governance practices or corporate governance index;

$Size_i$– company size, measured as natural logarithm of its total assets;

Lev_i – company leverage;

$Bidask_i$ – relative difference between ask price and bid price of a company shares;

$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4$ – unknown coefficients;

ε_i – stochastic term.

The variables were selected in accordance with prior research on the topic (Berezinets, Ilina, Cherkasskaya, 2013).

2.1.2 Variables description

Detailed variables description is provided in Table 1 (all data is collected at the end of each year, while bid-ask spread is calculated as an average for each year).

Table 1. Description of variables

Variable	Description
Dependent variable	
TQ	Tobin's Q ratio is a variable that represents company market value calculated as: $$TQ = \frac{MVE + DEBT}{TA},$$ where MVE – company market capitalization, DEBT – sum of short term and long term liabilities net of current assets, TA – book value of total assets
Independent variable	
CGI	Corporate Governance Index, constructed on the basis of 7 categories of the Code of Corporate Governance using the principal component analysis
Control variables	
Size	Variable that reflects a company size, measured as natural logarithm of its total assets at the end of a year
Lev	Company leverage is a variable that describes company

	capital structure, calculated as total debt to total assets
Bidask	Average annual bid-ask spread is a variable that measures liquidity of company ordinary shares calculated as: $Bidask = \frac{ask - bid}{ask} * 100\%,$ where ask – share ask price, bid – share bid price

It is worth to mention that industry defining binary variables were intentionally not included in the model, since it was assumed that investors measuring company value as Tobin's Q are indifferent to the industry factor. In other words, from the viewpoint of value the company creates on its assets, shareholders evaluate the company based on the presence of efficient mechanisms of corporate governance. Moreover, the Code offers provisions which are unique for all Russian public companies, which indicates that there is no sense in division of the provisions depending on the industry.

2.1.3 Corporate Governance Index (CGI) construction

First of all, let us describe existing methods of assessment of the level of compliance with best corporate governance practices. The most cited articles (Gompers, Ishii, Metrick, 2003; Black, Love, Rachinsky, 2006; Berezinets, Ilina, Orlova, 2009) construct indices using a set of criteria on several categories. Each company is given a certain amount of points for compliance, partial compliance and neglection of a criterion. Some papers charge penalty points if a criterion is neglected, so that companies with higher scores have lower level of corporate governance; others add points for compliance with a criterion, which means that higher scores correspond to more advanced companies in terms of corporate governance. The index is calculated as a weighted sum of scores for each category.

The next step is to determine weights attributed to each category. There are several approaches to weights allocation while constructing corporate governance indices. Currently many stock exchanges construct CGIs, however procedures remain confidential and only results are disclosed. Speaking about extensive amount of research papers, engaged in CGI construction, academicians assign either equal, or arbitrary chosen weights to components. Some papers (Larcker, Richardson, Tuna, 2007; Ammann, Oesch, Schmid, 2011) use a statistical procedure to allocate weights. PCA-based index has considerable advantages over other indices, as its measurement error was documented to be lower.

Assessment of the level of compliance with the Code was conducted on the basis of the form recommended to Russian public companies by the Moscow stock exchange. The information letter includes 18 key criteria and 41 principles on 7 categories, corresponding to the chapters of the Code. The table with criteria is provided in Appendix 2.

The compliance with each criterion was evaluated using the following methodology: 2 points were given for complete compliance, 1 point was added in case of partial compliance, and 0 points attributed to neglection of a criterion. In order to get scores for each category, 7 means were computed. Simply summing up all scores within each category is improper, since the categories have different number of criteria. The index was calculated as a weighted sum of means per each category, and the weights were determined using the principal component analysis. Principal component analysis allows to define components explaining the major part of the overall dispersion and present each component as a linear combination of the categories included in the analysis. In case of year 2014 the first component explains 36% of the overall dispersion, while in 2015 the percentage is even higher 47%. The weights were calculated as squares of coefficients in the linear combination with their sum equal to 1.

In order to define whether the principal component analysis can be applied to the sample, Kaiser-Meyer-Olkin test was conducted. All categories were given estimates higher than 0.8, which brings us to conclusion that the sample is adequate and principal component analysis can be run. Since different weights were gained for years 2014 and 2015, averages were calculated. The categories and corresponding weigts are presented in Table 2.

Table 2. Categories included in CGI

Category	Number of principles	Weight		
		2014	2015	Average
C1. Shareholder rights and equal conditions to exercise such rights	4	0.09	0.13	0.11
C2. Board of directors	11	0.24	0.18	0.21
C3. Corporate secretary	3	0.065	0.095	0.08
C4. Remuneration sytem	4	0.04	0.15	0.095
C5. Risk management and internal control system	6	0.19	0.16	0.175
C6. Information disclosure	11	0.25	0.21	0.23
C7. Material corporate actions	2	0.125	0.075	0.1

Based on the calculated weights the formula for CGI calculation can be written in the following form:

$$CGI = 0.11 * C_1 + 0.21 * C_2 + 0.08 * C_3 + 0.095 * C_4 + 0.175 * C_5 + 0.23 * C_6 + 0.1 * C_7 \quad (3)$$

In accordance with the results of the principal component analysis the most important categories are “Information disclosure”, “Board of directors” and “Risk management and internal control system” which is supported by the number of principles on these three categories. Indeed, the board of directors plays a crucial role in corporate governance performing as a mediator between shareholders and managers. Increasing number of academic papers studying different characteristics of the board proves emphasizes the importance of this mechanism. Information disclosure is another important corporate governance mechanism providing shareholders with all necessary information about the company performance, decisions taken within the company and actions that may influence their wealth. As for internal control system, it makes a significant contribution to strategy realization and goals achievement by the company.

2.1.4 Sample description

The sample selected for the research includes companies listed on the Moscow Exchange and included in the broad market index (MICEXBMI). As it was previously mentioned, there is a set of requirements, including the disclosure of information on corporate governance, from the side of the exchange that companies have to follow in order to be traded. The broad market index comprises 100 securities leading in terms of liquidity, capitalization and free-float coefficient. Financial companies, such as banks, insurance companies and investment funds were excluded from the sample due to specifics of their activities and different requirements imposed on them. Besides, according to the letter of the Bank of Russia No. 06-52/2825 dated 30 March 2015, companies traded on the exchange are obligated to disclose information on compliance with the Code and advised to use the form provided in the Moscow Exchange letter No. 31-14/236 dated 13 March 2015. However, some companies only briefly discussed their compliance with the Code and consequently were excluded from the sample due to information insufficiency. As a result, 62 companies that used the recommended form or described compliance in detail were retained in the sample.

As for data sources, all information on compliance with the Code was collected manually from companies’ annual reports and supplements to annual reports, placed on their official websites. Almost all financial data was collected from companies’ financial statements, while in order to obtain bid and ask prices Thomson Reuters database was used. The data on market capitalization, that was necessary for Tobin's Q calculation, was collected from the Moscow Exchange website.

The analyzed time period accounts for 2014 and 2015, since the Code of Corporate Governance was issued in 2014, and still many companies have not published their annual reports for 2016. This time horizon was selected in order to analyze the most recent data and therefore come up with findings that will be of great interest today.

62 companies included in the sample represent 11 industries: 4 companies refer to oil & gas industry, 12 – metals & mining, 21 – energy, 4 – telecommunications, 3 – retail, 5 – chemical, 4 – food, 4 – construction, 3 – transport and logistics, both media and aircraft industries are represented by 1 company. The distribution of the companies among industries is presented on Figure 2.

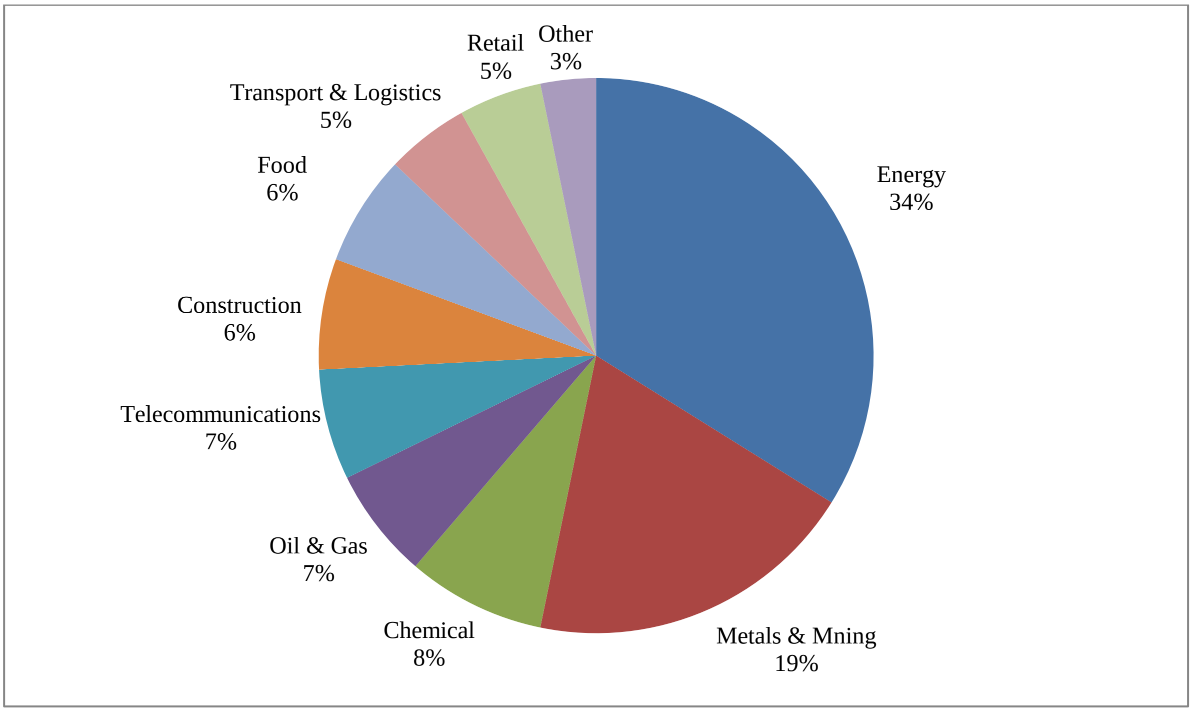

Figure 2. Distribution of companies among industries

2.1.5 Descriptive statistics

Descriptive statistics of all seven variables used in CGI construction is presented in Table 3.

Table 3. Descriptive statistics of CGI variables

Variable name	Mean	Standard deviation	Min	Max
Rights	1.422	0.483	0.333	2
Board	1.131	0.386	0.273	1.818
Secretary	1.161	0.803	0	2
Remuneration	1.423	0.472	0.5	2
Control	1.62	0.437	0	2
Disclosure	1.616	0.313	0.455	2
Actions	1.319	0.515	0	2

As we can see from the table, the most challenging principles of the Code refer to the board of directors and corporate secretary. This finding can be explained by the fact, that the chapter "The company's Board of Directors" is the largest in the Code, and companies face difficulties in complying with all its provisions. As for the corporate secretary, major part of companies underline that his duties are still distributed between other parties or carried out by the board secretary.

Since the index is constructed based on 7 categories, it is interesting to analyze the level of compliance with each of them and consider the most relevant principles. In general the analysis below is provided for year 2015, while in some cases numbers for 2014 are also specified.

Shareholder rights observance

More than a half of the sample (59.7%) approved the document setting forth key procedures to prepare for, convene and hold general meetings of shareholders, that is in line with the Code. Only one company (PIK Group) did not adopt the document, though in practice it informs shareholders about holding a general meeting 30 days before it, announces the record date at least 7 days prior to this date and provides additional information in compliance with the Code. Other companies introduced such document, but it should be corrected in order to fit the Code. The most frequent violation mentioned by companies is notifying shareholders about the record date 5 days beforehand. The 5-day period is set by the government and many companies claimed that in the nearest future they are going to extend it.

37 companies out of 62 guarantee the presence of the management and control bodies, so that shareholders can freely ask questions and be aware of the company operations. Only 5 companies do not observe this provision and state that it is not specified in internal documents or associated with difficulties. For instance, RBC does not invite candidates to management and control bodies to meetings, as shareholders are not interested in communication with them.

One third of companies report on prevention of artificial redistribution of corporate control with this principle formulated in internal documents. Other companies either employ quasi-treasury shares for voting, or claim that this recommendation is not applicable to them, since they do not have preferred or quasi-treasury shares. However, they do not account for other ways of corporate control redistribution. Finally, 38 companies (61.3%) approved the internal regulation stipulating their dividend policy in compliance with the Code recommendations.

The board of directors

The Code suggests that the board chairman should be independent and sets more strict criteria of independence than the Moscow Exchange requires. However, only 18.3% of companies from the sample report on nominating an independent director as a chairman on board or assigning a senior independent director in 2014, while in 2015 this share is 24.2%. According to the form suggested by the Moscow Exchange, companies are advised to comment on the reasons of recommendations negligence or partial observance. The most common grounds are competences, knowledge and experience of the chairman, who is believed to take more balanced decisions, and short time period passed since the Code was issued.

Another important principle, which is supposed to improve the board efficiency, is the proportion of independent directors. 46.8% of companies fully observe this recommendation in 2014 and 2015. Speaking about the assessment of the board performance, only 19.4% of companies document both conducting a regular internal assessment (at least once per year) and engaging an external organization at least once in 3 years. At the same time 54.8% of companies report on holding no assessment during last year in 2014 (in 2015 this share slightly decreased to 48.4%).

The distribution of companies depending on the compliance with the provisions on forming board committees in 2015 is presented in Figure 3. Full observance of the recommendations on committees signals that they consist of only independent directors in case of audit and remuneration committees, and the majority of members are independent in case of nomination committee. Partial observance means that companies formed a committee, but its structure does not follow the recommendations, while absence of a committee is equal to neglecting a principle.

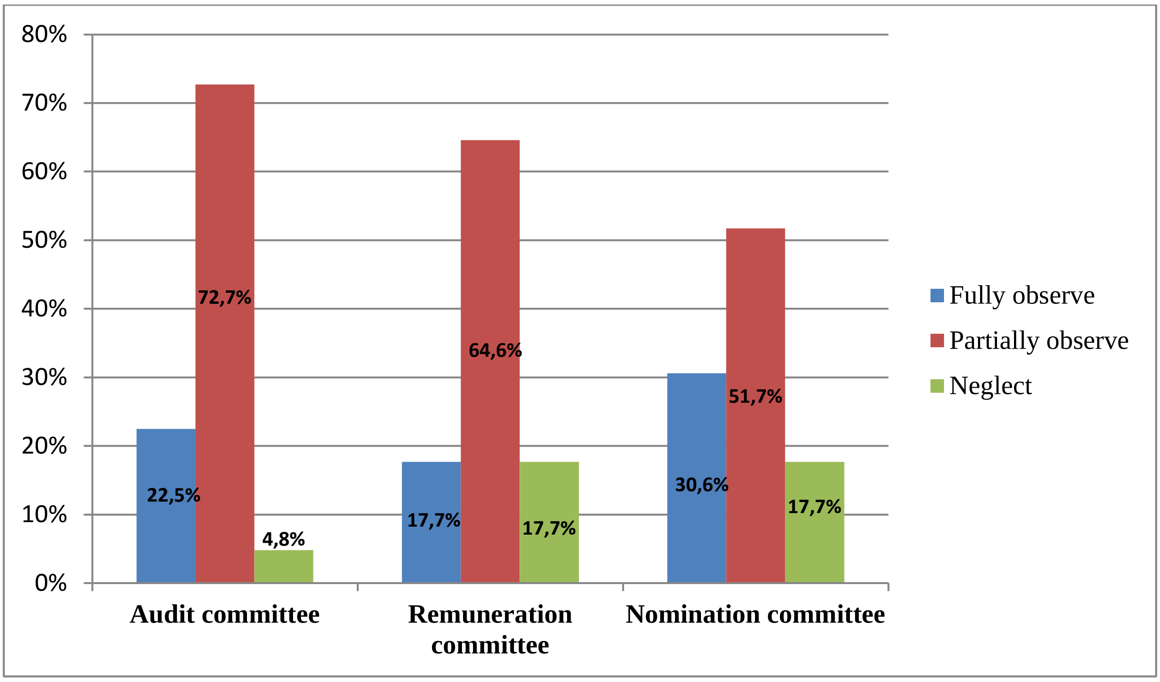

Figure 3. Distribution of companies depending on their compliance with the provisions on committees

Corporate secretary

25.8% of companies do not have a position of corporate secretary, and his responsibilities are carried out by other persons. 43.5% of the sample did not adopt the document on corporate secretary setting forth his rights and obligations. In 45.2% of companies the corporate secretary does not occupy other positions and have enough resources to efficiently perform his duties.

Remuneration system

The least frequently observed principle suggests putting in place a long-term incentive program for the executive body members and other key managers (only 30.6% of companies comply with it). In this case managers are less probable to pursue short-term goals and thus act in shareholders' interests. 67.7% of companies specify payments, benefits and privileges available to the board and executive body members and other key managers in the company internal regulations. 64.5% of the sample pay no other cash remuneration to the board members than their fixed annual remuneration. The majority of companies (90.3%) do not provide the board members with an opportunity to participate in the company stock options plan and they can dispose of the company's shares belonging to them regardless of their performance targets fulfillment. VSMPO-AVISMA Corporation is one of the companies that do not comply with this provision and it explains this deviation by having no remuneration policy.

Risk management and internal control

According to the Code, the board of directors is supposed to define the company's risk management and internal control principles and approaches. This recommendation is observed by 77.4% of companies. A standalone risk management and internal control unit is established in 83.9% of companies (in 2014 this share was 64.5%). Comparing results in 2014 and 2015, we can see that the number of such companies significantly increased. Speaking about the anti-corruption policy, 82.2% of companies specify measures to develop anti-corruption elements of their culture and organizational structure as well as respective rules and regulations in their anti-corruption policies. 6.5% of companies partially comply with this recommendation and make steps towards the formation of corporate culture and procedures to prevent corruption.

Moreover, the Code suggests setting up a standalone audit unit functionally reporting to the board of directors. 88.7% of companies follow this recommendation, however, in some of them the audit unit reports not to the board, but to the CEO, as in case of MOSENERGO. Internal audit policies are approved in 79% of companies.

Information disclosure

This chapter of the Code is presented by 11 principles, as well as the chapter on the board of directors. According to the data collected, 67.7% of companies approved an internal regulation defining the company information policy in compliance with the Code. For instance, LUKOIL publishes frequently asked questions from investors and shareholders and other useful information on the company website, as it is suggested by the Code. Only 8% of the sample do not disclose relevant information, such as announcements of a general meeting and the company annual report, in English.

One of the most complicated for compliance principle is to disclose a special memorandum setting out the controlling person's plans for the company. 66% of companies do not publish a memorandum and state that they are not aware of the controlling person plans. Moreover, sometimes the government performs as a controlling person, and companies claim that they cannot disclose such information.

Material corporate actions

The form suggested by the Moscow Exchange, includes only 2 principles that companies should report on. The first recommendation assumes that the company's charter should include a list (criteria) of transactions or other actions that are considered as material. Only 37% of companies fully comply with the provision, while 51.6% of the sample do not account for some types of transactions and actions that the Code considers as material. Speaking about the second principle, 53% of companies ensure equal terms and conditions for all shareholders when taking material corporate actions.

Descriptive statistics of the variables, used in regression analysis, is presented in Table 4.

Table 4. Descriptive statistics for regression analysis

Variable	Mean	Standard deviation	Min	Max
TQ	0.903	1.257	-0.229	10.037
Size	12.055	1.447	8.249	16.081
Lev	0.681	0.576	0.046	5.015
Bidask	0.814	1.22	0.057	9.26
CGI	1.409	0.288	0.578	1.903

It is interesting to note, that the mean of Tobin's Q is less than 1, which means that on average companies do not manage to create additional value on investors' investments. This result can be explained by the crisis and drop in share prices on the Russian market. At the same time, mean value of Tobin's Q slightly increased in 2015. The minimum value is negative, demonstrating that company's current assets exceed the sum of its total debt and market capitalization after rapid increase in current assets (in case of RAZGULAY Group it significantly increases its future expenses). Companies with negative Tobin's Q finance their current assets with equity, not with debt. The lowest values of Tobin's Q are demonstrated by RAZGULAY Group, LSR Group, Korshynov Mining Plant, PROTEK and Pharmstandard. Companies with the highest values of ratio comprise Magnit, RBC, PhosAgro and MegaFon.

Talking about leverage, company with the highest ratio is RBC, which is due to specifics of media industry the company operates in. Companies from this industry are usually characterized by small amounts of assets. List of companies with the lowest leverage includes Russian Aquaculture, Korshynov Mining Plant, Unipro and Krasnoyarsk Hydropower Plant.

The most illiquid companies in accordance with bid-ask spread values are Korshynov Mining Plant, Krasnoyarsk Hydropower Plant, FAR-EASTERN ENERGY COMPANY and Synergy. As it can be seen from Table 4, the highest value of bid-ask spread equals to 9.26%. This relatively small value can be explained by the sample peculiarities, since the sample comprises companies with the most liquid securities.

Speaking about the level of compliance with the Code, the most advanced companies are Sistema, Magnitogorsk Iron & Steel Works, MMC Norilsk Nickel and MTS. Such companies as RBC, VSMPO-AVISMA Corporation, RusHydro and T Plus demonstrate low CGI and poor compliance with the Code.

2.1.6 Results of regression analysis

Regression analysis was accomplished in STATA program and the results are presented in Table 5. In order to define which model is more appropriate to be used in the research, Hausman and Breusch-Pagan LM tests were conducted in STATA. As a result, random effects model was proved to be the most adequate. The constructed model is statistically significant, which provides opportunities for its interpretation.

Table 5. Results of regression analysis

Variable	TQ
Size	-0.177**
Lev	0.853*
Bidask	-0.072
CGI	0.371*
Cons	2
Number of observations	124
R^2	0.3836

Symbols * and ** correspond to 5% and 10% level of significance respectively

Company size measured as a natural logarithm of its total assets is significant and negatively associated with Tobin's Q. These findings were previously demonstrated by other researchers, who argue that big companies may have problems with resources allocation among interconnected divisions. Besides this, problems of control and communication are more probable in big companies. There is a strong positive relationship between leverage and Tobin's Q. This can be explained by the fact, that companies with high leverage have great potential for future development, which is sufficient for borrowing justification (Black, Love, Rachinsky, 2006). Bid-ask spread value turned out to be insignificant, which does not allow to reveal any connection with company market value.

Finally, since corporate governance index (CGI) measuring level of compliance with best corporate governance practices is statistically significant, it is possible to interpret the results and accept *Hypothesis* H_1. Therefore, we may conclude that there is a positive relationship between the level of compliance with best corporate governance practices and company market value for Russian public companies.

Conclusion

The goal of this paper was to investigate the relationship between the level of compliance with best corporate governance practices and company market value. In order to achieve this goal, all stated research objectives were fulfilled.

Based on the results of regression analysis, we may conclude that compliance with best corporate governance practices contributes to additional value creation. This finding is in line with previous research papers dedicated to the investigation of the relationship between corporate governance indices and market measures of company value (Gompers, Ishii, Metrick, 2003; Black, Jang, Kim, 2006).

Therefore, the conducted research has several managerial implications. First recommendation is addressed to managers, shareholders and boards of directors of Russian public companies, who are advised to improve the quaity of corporate governance within the company and scrupulously comply with provisions of the Code. This would allow companies to attract new investors, who value companies with advanced corporate governance higher with other things being equal. Moreover, compliance with the Code would contribute to increase in confidence that shareholders and investors put in the company.

Besides this, creditors are also interested in whether the company complies with best corporate governance practices. They should be confident that the company will be able to pay off its debt in future and thus estimate risks associated with the company. Since companies with high level of corporate governance have a strong reputation, creditors would associate them with lower risks and thus provide loans on better terms.

Studying reports on compliance with the Code would also be beneficial for individual investors. Firstly, the fact that the company complies with the Code and therefore observes shreholders' rights is a signal for the investor that his rights will not be violated. Secondly, companies complying with the Code more probably have conscientious managers and suggest higher return on invested capital. Since investors are interested in maximization of their wealth, they should consider investing in companies with higher level of compliance with the Code.

The paper might also be interesting for regulators. As for today, in order to be included in the first and second quotation levels, companies have to meet certain requirements set by the Moscow Exchange. In order to motivate companies to observe the Code provisions, the Exchange can strengthen its requirements. As compliance with the Code contributes to higher market valuation and companies will try to fulfill its recommendations, regulators are suggested to systematically revise and elaborate the Code by adding new provisions and improving existing ones. This will lead to significant increase in quality of corporate governance in Russian public companies.

All in all, increased interest to corporate governance from the side of investors, shareholders, regulators and creditors will create benefits for companies complying with the Code due to growing investments, decreasing cost of capital and higher liquidity.

As for further opportunities for the research, it would be interesting to assess how much compliance with the Code would cost and reveal in which cases it would be economically beneficial for companies.

Speaking about the limitations of the study, first of them is a relatively small data sample (62 companies) and time period (2 years). The decision to select companies included in the broad market index is supported by high liquidity of their shares, while not all companies from the index report on their compliance with the Code. The relatively small time period was chosen due to the Code recent issuance and companies' annual reports unavailable for 2016. Secondly, due to specifics of the Russian market, the distribution of companies among industries is unequal with the major part of companies operating in Energy and Metal & Mining industries. Therefore, the results might be potentially inapplicable to companies from other industries. Finally, the research was conducted only for Russian public companies and its results cannot be extended to other countries.

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Appendix 1. Sample composition

No.	MOEX ticker	Company name
1	LKOH	LUKOIL
2	MGNT	Magnit
3	GMKN	MMC Norilsk Nickel
4	ROSN	Rosneft
5	MTSS	MTS
6	TATN	TATNEFT
7	URKA	Uralkali
8	MFON	MegaFon
9	RTKM	Rostelecom
10	ALRS	ALROSA
11	CHMF	Severstal
12	HYDR	RusHydro
13	NLMK	NLMK
14	AFKS	Sistema
15	PHOR	PhosAgro
16	PIKK	PIK Group
17	BANE	Bashneft
18	UPRO	Unipro
19	MAGN	Magnitogorsk Iron & Steel Works
20	LSRG	LSR Group
21	DIXY	DIXY Group
22	PHST	Pharmstandard
23	GCHE	Cherkizovo Group
24	TRMK	Pipe Metallurgical Company
25	IRAO	Inter RAO
26	MVID	M.video
27	AFLT	Aeroflot
28	FEES	Federal Grid Company of Unified Energy System
29	RSTI	ROSSETI
30	AKRN	Acron
31	VSMO	VSMPO-AVISMA Corporation
32	MSTT	MOSTOTREST

33	TGKA	TERRITORIAL GENERATING COMPANY #1
34	OGKB	The Second Generation Company of the Wholesale Power Market
35	MTLR	Mechel
36	MSRS	Moscow Unified Electric Grid Company
37	MSNG	MOSENERGO
38	PRTK	PROTEK
39	ENRU	Enel Russia
40	RASP	Raspadskaya
41	IRGZ	Irkutsk Public Joint Stock Company of Energetics and Electrification
42	SYNG	Synergy
43	MRKC	Interregional Distribution Grid Company of Centre
44	KRSG	Krasnoyarsk Hydropower Plant
45	DVEC	FAR-EASTERN ENERGY COMPANY
46	VTGK	T Plus
47	CHZN	Chelyabinsk Zinc Plant
48	MSSB	Mosenergosbyt
49	UNAC	United Aircraft Corporation
50	FESH	FAR-EASTERN SHIPPING COMPANY
51	KOGK	Korshynov Mining Plant
52	LSNG	LENENERGO
53	TGKD	Quadra-Power Generation
54	VRAO	RAO Energy System of the East
55	MRKV	Interregional Distribution Grid Company of Volga
56	HALS	HALS-Development
57	KBTK	Kuzbasskaya Toplivnaya Company
58	AQUA	Russian Aquaculture
59	MRKY	Interregional Distribution Grid Company of South
60	RBCM	RBC
61	UTAR	UTair Aviation
62	GRAZ	RAZGULAY Group

Appendix 2. Recommended form of the Code of Corporate Governance compliance report

No.	Corporate governance principle or key criterion (recommendation)
I. Shareholder rights and equal conditions to exercise such rights	
Key criterion 1.1.	The company should ensure equal and fair treatment of each shareholder exercising their right in managing the company. Corporate governance framework and practices should ensure equality for the shareholders owning the same type (class) of shares, including minority and non-resident shareholders, and their equal treatment by the company
Principle 1.1.1.	The company should approve an internal regulation setting forth key procedures to prepare for, convene and hold general meetings of shareholders in compliance with recommendations of the Corporate Governance Code, including the company's obligations to: notify shareholders of general meetings and provide access to the respective materials, as well as publish the respective notice and materials on the corporate website, at least 30 days prior to such meeting, unless required to do so earlier by the Russian law; announce the record date at least seven days prior to such date; provide supplementary information and materials on the general meeting agenda as recommended by the Corporate Governance Code
Principle 1.1.2.	The company should undertake to enable its shareholders to put questions on the company's operations to members of the management and control bodies, Audit Committee, Chief Accountant, company's auditors, and nominees to management and control bodies, during the general meeting and in the course of respective preparations. The said obligations should be set forth in the company's Charter or internal regulations
Principle 1.1.3	The company should observe the principle of preventing any action that may result in an artificial redistribution of corporate control (for example, voting with quasi-treasury shares, decision to pay dividends on preferred shares regardless of limited financial capacities, decision not to pay dividends on preferred shares as required by the Charter regardless of sources being sufficient for payment). The said obligations should be set forth in the company's Charter or internal regulations.
Key criterion 1.2	Shareholders should be given equal and fair opportunities to receive a share of the company's profit in the form of dividends
Principle 1.2.1.	The company should approve an internal regulation stipulating its dividend policy in compliance with recommendations of the Corporate Governance Code, including, inter alia: procedures to determine a portion of the company's profit (for companies issuing consolidated financial statements – a minimum portion (share) of consolidated net profit) to be distributed in the form of dividends, and conditions to declare dividends;

	minimum dividends payable on different types (classes) of shares; mandatory disclosure of the document governing the company's dividend policy on its corporate website
II. The company's Board of Directors	
Key criterion 2.1	The Board of Directors' core responsibilities should include determining the company's long-term targets, key performance indicators, main risk management and internal control principles and approaches and remuneration paid to the Board and executive body members, strategic governance, control of the company's executive bodies, etc
Principle 2.1.1.	The company's Board of Directors was established, which should: determine the company's long-term targets and KPIs; control the company's executive bodies; define the company's risk management and internal control principles and approaches; articulate the company's policy on remunerating the Board and executive body members and other key managers
Key criterion 2.2.	The Board of Directors should manage the company in an efficient and competent manner and make fair and independent judgements and decisions in line with the best interests of the company and its shareholders. The Chairman of the Board of Directors should ensure that the Board of Directors discharges its duties efficiently and effectively. The Board of Directors should ensure proper discharge of its duties by conducting meetings attended by directors and making the respective preparations
Principle 2.2.1.	The Board should be chaired by an independent director, or a senior independent director supervising the activities of other independent directors and interacting with the Board's Chairman should be appointed from among the elected independent directors
Principle 2.2.2.	The company's internal regulations should stipulate the procedure to prepare for and hold the Board's meetings, enabling the directors to make proper preparations, including, inter alia: meeting notice period; deadlines for circulating voting ballots and submitting the completed ones in case of meetings held in absentia; a possibility of submitting and taking into account a director's written opinion on the agenda items in case they are not present at an in-person

	meeting; a possibility of participating in the meeting and voting via audio- or video conferencing
Principle 2.2.3.	Resolutions on the most important matters should be passed at the Board's in-person meetings. The list of such matters should be compliant with recommendations of the Corporate Governance Code
Key criterion 2.3.	The Board of Directors should be composed of a sufficient number of independent directors
Principle 2.3.1.	Independent directors should make up at least one third of the elected Board members
Principle 2.3.2.	Independent directors should fully meet the independence criteria set forth in the Corporate Governance Code
Principle 2.3.3.	The Board of Directors (the Nomination/ HR, Compensation Committee) should verify a Board nominee's compliance with the independence criteria
Key criterion 2.4.	The Board of Directors should set up committees to preview key matters related to the company's operations
Principle 2.4.1.	The Board of Directors should establish an Audit Committee made up of independent directors. Its responsibilities should be set forth in the company's procedures and be compliant with recommendations of the Corporate Governance Code
Principle 2.4.2.	The Board of Directors should establish a Compensation Committee made up of independent directors, which may be combined with the Nomination/HR Committee. Its responsibilities should be set forth in the company's procedures and be compliant with recommendations of the Corporate Governance Code
Principle 2.4.3.	The Board of Directors should establish a Nomination/HR Committee predominantly made up of independent directors, which may be combined with the Compensation Committee. Its responsibilities should be set forth in the company's procedures and be compliant with recommendations of the Corporate Governance Code
Key criterion 2.5.	The Board should assess the quality of the board, its committees and members performance
Principle	The Board's performance should be assessed regularly at least once a year, and at least once in three years the company should engage an external

2.5.1.	advisor to conduct such assessment
III. The company's Corporate Secretary	
Key criterion 3.1	The company's Corporate Secretary (or a dedicated business unit headed by such) should ensure efficient ongoing interaction with shareholders, coordinate the company's efforts to protect shareholder rights and interests and support the Board's activities
Principle 3.1.1.	The Corporate Secretary should report to the Board of Directors and should be appointed or removed from office by the Board's resolution or approval
Principle 3.1.2.	The company should approve an internal regulation setting forth the Corporate Secretary's rights and obligations (Regulations on the Corporate Secretary) as recommended by the Corporate Governance Code
Principle 3.1.3.	The Corporate Secretary should not hold any concurrent positions in the company. Their responsibilities should be compliant with recommendations of the Corporate Governance Code. The Corporate Secretary should have sufficient resources to discharge his/her duties
IV. Remuneration of the Board and executive body members and other key managers	
Key criterion 4.1.	Remuneration paid by the company should be sufficient to attract, motivate and retain persons that have competencies and qualifications required by the company. The Board and executive body members and other key managers should be remunerated in compliance with the company's remuneration policy
Principle 4.1.1.	Payments, benefits and privileges available to Board and executive body members and other key managers should be specified in the company's internal regulations
Key criterion 4.2.	The system of remuneration for the Board members should ensure that the directors' financial interests are aligned with long-term financial interests of shareholders
Principle 4.2.1.	The company should pay no other cash remuneration to the Board members than their fixed annual remuneration
Principle 4.2.2.	The Board members should not be entitled to participate in the company's stock option plans, and their right to dispose of the company's shares owned by them should not be linked to their performance targets
Key criterion 4.3.	The system of remuneration for the executive body members and other key managers should be linked to the company's results and their personal contribution to those

Principle 4.3.1.	The company should put in place a long-term incentive program for the executive body members and other key managers
V. Risk management and internal control system	
Key criterion 5.1.	The company should put in place an effective risk management and internal control system to guarantee, in a reasonable manner, fulfilment of the company's goals
Principle 5.1.1.	The Board of Directors has defined the Company's risk management and internal control principles and approaches
Principle 5.1.2.	The company should establish a standalone risk management and internal control unit
Principle 5.1.3.	The company should draft and implement an anti-corruption policy specifying measures to develop anti-corruption elements of its culture and organizational structure as well as respective rules and regulations
Key criterion 5.2.	The company should arrange for an internal audit, to assess reliability and performance of the risk management and internal control system on a regular and independent basis
Principle 5.2.1.	The company should set up a standalone internal audit unit functionally reporting to the Board of Directors. The said unit's functions should be compliant with recommendations of the Corporate Governance Code and include: assessing internal control performance; assessing risk management performance; assessing corporate governance framework (in case there is no Corporate Governance Committee)
Principle 5.2.2.	Head of Internal Audit should report to the Board of Directors and should be appointed or removed from position by the Board's resolution
Principle 5.2.3.	The company should approve an internal audit policy (Regulations on Internal Audit) defining internal audit goals, objectives and functions
VI. Disclosure of information about the company and its information policy	

Key criterion 6.1.	The company and its operations should be transparent for its shareholders, investors and other stakeholders
Principle 6.1.1.	The company should approve an internal regulation defining its information policy as recommended by the Corporate Governance Code. The company's information policy should provide for the following ways of engaging investors and other stakeholders: a dedicated page at the corporate website featuring FAQs from investors and shareholders and respective replies, a regularly updated corporate calendar, and other useful information; regular meetings between executive body members and other key managers and analysts; regular presentations, including via teleconferences and webcasts, and meetings attended by governance body members and other key managers, including those related to release of financial statements or the company's key investment projects and strategic plans
Principle 6.1.2.	The company's executive bodies should be in charge of implementing its information policy. Control over proper disclosure and compliance with the information policy should be exercised by the company's Board of Directors
Principle 6.1.3.	The company should put in place procedures to align all its functions and structural units whose activities are related to or may require information disclosure
Key criterion 6.2.	The company should, in due time, disclose up-to-date, complete and reliable information on its operations, to enable its shareholders and investors to make informed decisions
Principle 6.2.1.	If foreign investors hold a substantial share of the company's capital, the company should, along with disclosure of information in Russian, disclose key information about itself (including an announcement of a general meeting to be held, its annual report) in a foreign language generally accepted on the financial market
Principle 6.2.2.	The company should disclose information both about itself but also about legal entities controlled by and material to the company
Principle 6.2.3.	The company should disclose annual and interim (half-year) consolidated or individual financial statements prepared in accordance with the International Financial Reporting Standards (IFRS). The company's annual consolidated or individual financial statements should be disclosed together with the auditor's report, while its interim (half-year) consolidated or individual financial statements – together with the auditor's review report or the auditor's opinion
Principle	The company should disclose a special memorandum setting out the controlling person's plans for the company. The said memorandum should

6.2.4.	comply with the recommendations of the Corporate Governance Code
Principle 6.2.5.	The company should ensure disclosure of biographical details of its directors, including information as to whether they are independent directors and timely disclosure of information as to whether a director has lost their independent status
Principle 6.2.6.	The company should disclose information on its capital structure in compliance with recommendations of the Corporate Governance Code
Principle 6.2.7.	The company's annual report should include the following additional information recommended by the Corporate Governance Code: a brief survey of the most significant transactions entered into by the company and by legal entities controlled by it, including associated transactions, during the past year; a report by the board of directors (including committee reports) for the year containing, inter alia, information on the number of meetings held in person (in absentia), attendance of each director, a description of the most important and complicated matters discussed at meetings of the Board of Directors and its committees, and the principal recommendations by the committees to the Board of Directors; information on shares in the company directly or indirectly owned by its directors and/or members of its executive bodies; information on whether the company's directors and/or members of its executive bodies have conflicts of interest (including those linked to their membership in competitors' governance bodies); a description of the remuneration system for directors, including the amount of individual remuneration payable to each director based on annual performance (broken down into the base fee, additional remuneration for chairing the Board of Directors and for the chairing / membership of the Board of Directors' committees, the extent of participation in a long-term incentive program, the amount of each director's participation in an option plan, if any), reimbursement of expenses associated with the Board of Directors' membership, and costs incurred by the company in connection with liability insurance for its directors in their capacity of governance body members; information on the total remuneration for the year: a) in respect of a group of at least five top paid executive body members and other key managers of the company, broken down by type of remuneration; b) in respect of all executive body members and other key managers to whom the company's remuneration policy extends, broken down by type of remuneration; information on the sole executive body's remuneration for the year which they have received or are to receive from the company (legal entity

	from a group of organizations that includes the company), broken down by type of remuneration, both for performing their duties of the sole executive body and on other grounds
Key criterion 6.3.	The company should provide information and documents requested by its shareholders in accordance with the principle of equal and unhindered accessibility
Principle 6.3.1.	In accordance with the company's information policy, its shareholders with equal quantity of the company's voting shares should be given equal access to the company's information and documents
	VII. Material corporate actions
Key criterion 7.1.	Actions which will or may materially affect the company's share capital structure and its financial position and accordingly the position of its shareholders («material corporate actions») should be taken on fair terms ensuring that the rights and interests of the shareholders and other stakeholders are observed
Principle 7.1.1.	The company's Charter should include a list (criteria) of transactions or other actions deemed to be material corporate actions the consideration of which should be referred to the jurisdiction of the Board of Directors, including: company's reorganization, acquisition of 30% or more of the company's voting shares (takeover), increasing or reducing the company's charter capital, listing and delisting of the company's shares; transactions on sale of shares (interests) in legal entities controlled by the company material to the latter as a result of which the company loses control over such legal entities; transactions, including associated transactions, with property of the company or legal entities controlled by the company whose value exceeds the amount specified in the company's Charter or which is material to the business of the company; creation of a legal entity under the company's control that is material to the business of the company; disposal by the company of its treasury and quasi-treasury shares
Key criterion 7.2.	The company should provide a procedure for taking material corporate actions that would enable its shareholders to receive full information about such actions in due time and influence them, and also guarantee that the shareholder rights are observed and duly protected when such actions are taken
Principle	The internal documents of the company should provide for a principle of ensuring equal terms and conditions for all shareholders of the company when taking material corporate actions affecting the rights and legitimate interests of the shareholders, and also establish additional measures to protect

7.2.1.	rights and legitimate interests of the company's shareholders stipulated by the Corporate Governance Code, including: retention of an independent appraiser with an established impeccable reputation in the market and experience in the relevant area to determine the value of the property disposed of or acquired pursuant to a major transaction or a material related-party transaction; valuation of the company's shares at their repurchase or redemption by an independent appraiser with an established impeccable reputation in the market and experience in the relevant area, having regard to the weighted average price of the shares over a reasonable period of time, without regard to the effect of the transaction in question to be entered into by the company (inter alia without regard to changes in the price of shares in connection with dissemination of information on the company's entering into the transaction in question), and also without regard to a discount for selling shares in a non-controlling block; expansion of the list of grounds on which members of the company's Board of Directors as well as other persons as per the applicable law are deemed to be interested parties in transactions of the company for the purpose to assess the actual linkages between the persons concerned